(11)

FILED
JAN 22 2007
OFFICE OF THE CLERK
SUPREME COURT, U.S.

No. 06-480

IN THE

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,

Petitioner,

v.

PSKS, INC., doing business as
Kay's Kloset . . . Kay's Shoes,

Respondent.

On Writ of Certiorari to the
United States Court of Appeals for the Fifth Circuit

BRIEF OF *AMICI CURIAE* ECONOMISTS IN SUPPORT OF PETITIONER

Joseph Angland
Counsel of Record
Stephen V. Bomse
August T. Horvath
HELLER EHRMAN LLP
Times Square Tower
Seven Times Square
New York, New York 10036
212-832-8300

January 22, 2007

QUESTION PRESENTED

Should minimum resale price maintenance continue to be deemed *per se* unlawful under Section 1 of the Sherman Act, or, in light of modern economic understanding and antitrust policy, should it instead be subject to the rule of reason, like other vertical price and non-price restraints?

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES iv

INTEREST OF *AMICI CURIAE* 1

INTRODUCTION AND SUMMARY 1

ARGUMENT 4

I. MINIMUM RPM DOES NOT SATISFY THIS COURT'S STANDARD FOR APPLICATION OF THE *PER SE* RULE 4

A. The *Per Se* Rule Should Apply Only to Conduct that Almost Never Is Procompetitive and Almost Always Is Anticompetitive 4

B. Minimum RPM Can Be Procompetitive 4

1. Eliminating "Free Riding" 5

2. Ensuring Dealer Contribution to Product Quality 9

3. Managing Demand Uncertainty 10

C. The Economics Literature Does Not Support the Conclusion that Minimum RPM Often, Much Less Invariably, Has an Anticompetitive Effect 11

1. Minimum RPM's Enhancement of Interbrand Competition Offsets Its Effect on Intrabrand Competition 11

2. The Economics Literature Does Not Support the Conclusion that Minimum RPM Is Often Used to Facilitate Manufacturer Cartels 12

3. The Economics Literature Does Not Support the Conclusion that Minimum RPM Is Often Used to Facilitate Reseller Cartels 14

4. The Disagreements in the Economics Literature Provide No Basis for a *Per Se* Rule 15

II. RULE OF REASON TREATMENT OF MINIMUM RPM IS NEEDED TO MAINTAIN DESIRABLE CONSISTENCY BETWEEN PRICE AND NON-PRICE RESTRAINTS 16

CONCLUSION 19

APPENDIX: LIST OF *AMICI CURIAE* 1a

TABLE OF AUTHORITIES

Page

Cases

Broad. Music, Inc. v. CBS, Inc.,
441 U.S. 1 (1979) 4

Bus. Elecs. Corp. v. Sharp Elecs. Corp.,
485 U.S. 717 (1988) 12

Cont'l T.V., Inc. v. GTE Sylvania Inc.,
433 U.S. 36 (1977). 2, 4, 12, 18

Dr. Miles Med. Co. v. John D. Park & Sons Co.,
220 U.S. 373 (1911) 1, 2, 18

N. Pac. Ry. Co. v. United States,
356 U.S. 1 (1958) 4

State Oil Co. v. Khan,
522 U.S. 3 (1997) 2, 18

Texaco Inc. v. Dagher,
126 S. Ct. 1276 (2006) 4

Statutes

15 U.S.C. § 1 ..... 1, 2

Publications

William S. Comanor et al., *Vertical Antitrust Policy as a Problem of Inference: The Response of the American Antitrust Institute* (Am. Antitrust Inst. Working Paper No. 05-04, Apr. 18, 2005) 16

Raymond Deneckere et al., *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*,
87 Am. Econ. Rev. 619 (1997) 11

Frank H. Easterbrook, *Contract and Copyright*,
42 Hous. L. Rev. 953 (2005) 12

Kenneth G. Elzinga & David E. Mills, *The Economics of Resale Price Maintenance*, *in* Issues in Competition Law and Policy (ABA Antitrust Section, Wayne Dale Collins, ed., forthcoming 2007) ..... *passim*

Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & Econ. 263 (1991).....14, 15

Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & Econ. 265 (1988).....10

Andrew N. Kleit, *Efficiencies Without Economists: The Early Years of Resale Price Maintenance*, 59 S. Econ. J. 597 (1993).....10

G. Franklin Mathewson & Ralph A. Winter, *The Incentives for Resale Price Maintenance Under Imperfect Competition*, 21 Econ. Inquiry 337 (1983).....7, 8

G. Franklin Mathewson & Ralph A. Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Indus. Org. 57 (1998).....6

Phillip Nelson, *Advertising as Information*, 82 J. Pol. Econ. 729 (1974).....8

Thomas R. Overstreet, Jr., *Resale Price Maintenance: Economic Theories and Empirical Evidence* (Bureau of Econ., Fed. Trade Comm'n 1983) ..... *passim*

Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 6 (1981).....12

F.M. Scherer, *Comment on Cooper et al.'s "Vertical Restrictions and Antitrust Policy,"* 1 Competition Pol'y Int'l 65 (2005) 16

F.M. Scherer, *Industrial Market Structure and Economic Performance* (3d ed. 1990) 10

Robert L. Steiner, *The Nature of Vertical Restraints*, 30 Antitrust Bull. 143 (1985).....10

George Stigler, *A Theory of Oligopoly*, 72 J. Pol. Econ. 44 (1964).....13

Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & Econ. 86 (1960).....7

Basil S. Yamey, *Origins of Resale Price Maintenance: A Study of Three Branches of Retail Trade*, 62 Econ. J. 522 (1952) 14

Other Authorities

U.S. Dep't of Justice & Fed. Trade Comm'n, *Horizontal Merger Guidelines* (Apr. 2, 1992).....13, 14

INTEREST OF *AMICI CURIAE*[1]

Amici, who are listed in the Appendix hereto, are professors and scholars who teach and write on economics, specializing in the economics of industrial organization, competition, and antitrust policy. They include members of the faculties of some of the nation's leading academic institutions. Eight of the *amici* have served as either Director of the Bureau of Economics of the Federal Trade Commission or Deputy Assistant Attorney General for Economic Analysis at the Antitrust Division of the Department of Justice (the highest-ranking economist at each agency).

Amici submit this brief to share with the Court their expertise in the economics of industrial organization, competition, and antitrust policy; to apprise the Court of developments in economic theory and research bearing on the question presented; and to further the goals of achieving economic efficiency, maximizing economic welfare, and adopting antitrust policy consistent with economic principles.

INTRODUCTION AND SUMMARY

The petition in this action addresses the antitrust treatment of minimum resale price maintenance ("RPM") agreements in which an upstream seller agrees with a buyer on the minimum price, or the exact price, at which the buyer will resell the goods. Minimum RPM has been treated as *per se* unlawful under Section 1 of the Sherman Act, 15 U.S.C.

---

[1] *Amici* file this brief solely as individuals, and not on behalf of any institutions or organizations with which they are affiliated. No counsel for a party has authored this brief in whole or in part and no person or entity, other than *amici* or their counsel, has made a monetary contribution to the preparation or submission of this brief. Both parties have filed letters with the Court consenting to the filing of all amicus briefs.

§ 1, since *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), except for the years 1937 to 1975 when it was partially exempted from the Sherman Act by statute. *See* Thomas R. Overstreet, Jr., *Resale Price Maintenance: Economic Theories and Empirical Evidence* 3-7 (Bureau of Econ., Fed. Trade Comm'n 1983). Other vertical restraints, including maximum RPM, in which a buyer and seller set a ceiling on the buyer's resale price, as well as almost all non-price vertical agreements, are now analyzed under the rule of reason, although they had previously been considered *per se* illegal. *See State Oil Co. v. Khan*, 522 U.S. 3 (1997) (maximum RPM); *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977) (vertical non-price agreements generally).

Amici urge the Court to reverse the decision of the United States Court of Appeals for the Fifth Circuit and hold that minimum RPM is subject to analysis under the rule of reason, rather than being illegal *per se*. This Court has frequently observed that the rule of reason is the presumptive standard for determining the legality of practices challenged as anticompetitive under the Sherman Act. *Per se* condemnation is reserved for conduct that almost never has a procompetitive effect and almost always has an anticompetitive effect.

In the lengthy period since this Court decided *Dr. Miles*, economic analysis of minimum RPM agreements has demonstrated that vertical restrictions between manufacturers and their dealers, including agreements on minimum resale prices, can enhance competition. Consistent with that teaching, this Court has overruled past decisions that held non-price vertical restraints and maximum RPM unlawful *per se*. The same reasoning should now lead this Court to treat minimum RPM in the same manner, thus abandoning an anachronistic distinction that finds no support in sound economic analysis.

RPM can have procompetitive effects under some circumstances, especially where manufacturers seek to deter free riding on welfare-enhancing investments in services by certain retailers. Even where free riding is not an issue, minimum RPM can sometimes be an efficiency-enhancing means to enforce commitments by resellers to invest in sales effort or to manage uncertainty in demand.

The economics literature does not support a conclusion that minimum RPM almost always produces anticompetitive effects. In many cases, interbrand competition precludes a manufacturer from setting resale prices above a competitive level. And regardless of the extent of interbrand competition, a manufacturer has, except in limited circumstances, little incentive to enrich its dealers by inducing them to impose noncompetitive mark-ups on its products. To the contrary, manufacturers generally have an incentive to require minimum mark-ups that will result in enhanced levels of service to increase total sales. That is a procompetitive effect that benefits manufacturers and consumers alike. While minimum RPM can be used in conjunction with a cartel at the manufacturer or dealer level, the economics literature does not indicate that it does so often, much less virtually all the time as would be necessary to justify a *per se* rule. Taken as a whole, the economics literature does not establish that minimum RPM satisfies this Court's strict criteria for *per se* treatment.

In *amici*'s view, moreover, it is important to bring the law governing non-price and price restraints into congruence. From an economics perspective, vertical price and non-price restraints are substantially identical in effect. Not only is there is no justification for treating the two types of restrictions in such a markedly disparate fashion where sound economic analysis fails to support the distinction, but doing so may force businesses to resort to non-price restraints in situations in which price restrictions may

provide the most effective and procompetitive way to ensure efficient conduct by dealers.

ARGUMENT

I. MINIMUM RPM DOES NOT SATISFY THIS COURT'S STANDARD FOR APPLICATION OF THE *PER SE* RULE

A. The *Per Se* Rule Should Apply Only to Conduct that Almost Never Is Procompetitive and Almost Always Is Anticompetitive

This Court has emphasized that antitrust claims are presumptively subject to rule of reason analysis and that *per se* condemnation is limited to a small class of alleged antitrust offenses whose character is well understood and that are virtually invariably harmful to competition. *See Texaco Inc. v. Dagher*, 126 S. Ct. 1276, 1279 (2006). More specifically, the *per se* rule should be applied only to practices that almost invariably have no procompetitive effects and almost invariably have significant anticompetitive effects—or, as the Court has put it, that have a "pernicious effect on competition and lack . . . any redeeming virtue." *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958), *quoted in GTE Sylvania*, 433 U.S. at 58; *see also GTE Sylvania*, 433 U.S. at 50 (finding *per se* rules appropriate for "conduct that is manifestly anticompetitive"); *Broad. Music, Inc. v. CBS, Inc.*, 441 U.S. 1, 19-20 (1979) (prescribing *per se* treatment when a "practice facially appears to be one that would always or almost always tend to restrict competition and decrease output"). Under this formulation, there is no justification for applying the *per se* rule to minimum RPM.

B. Minimum RPM Can Be Procompetitive

RPM agreements include either a specific price at which a product must be resold or a floor below which the reseller

may not price in reselling the product. (Often, as here, the upstream seller is a manufacturer and the reseller is a retailer. Although that is not always the case, *amici* will use the terms "manufacturer" and "retailer" to denote the upstream seller and reseller, respectively.) An RPM agreement establishes a minimum mark-up for the retailer (the difference between the resale price and the wholesale price from the manufacturer).

Generally, a manufacturer wants retail margins to be low; having sold the product to the retailer, it wants the retailing function to be performed as efficiently as possible, with competing retailers, in turn, passing on to consumers the lowest price consistent with retailers' providing desired services and continuing in business. In real-world markets, however, the incentives facing retailers may be out of alignment with those of manufacturers, to the detriment of the manufacturers' ability to compete effectively with the products of competing manufacturers. In such cases, minimum RPM can help to align these incentives and enhance the competitiveness of a manufacturer's product, thereby benefiting consumers.

1. Eliminating "Free Riding"

There is a consensus in the economics literature that minimum RPM can, in certain circumstances, remedy a free-riding problem and thereby increase competition and enhance consumer welfare. There is some dispute in the literature about how commonly and under what circumstances RPM has such effects, but the literature does not suggest that this is a rare or aberrational effect of RPM.

In purchasing many products, consumers value services performed at the retail level—that is, the provision of these services increases the value of the product for consumers, and some consumers are willing to purchase the product with these services, whereas they would not be willing to

purchase the product if the services were not provided. In some situations, "the increase in demand resulting from enhanced service, elicited through a protected retail margin, will more than offset a negative impact on demand of a higher retail price." G. Franklin Mathewson & Ralph A. Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Indus. Org. 57, 67 (1998). The result is an increase in total demand and sales. In such cases, consumer welfare generally will also increase compared with the world in which the product is offered at a lower price but without the dealer's services. *See* Kenneth G. Elzinga & David E. Mills, *The Economics of Resale Price Maintenance*, *in* Issues in Competition Law and Policy (ABA Antitrust Section, Wayne Dale Collins ed., forthcoming 2007), *available at* http://www.virginia.edu/economics/papers/mills/RPM for ABA.pdf.

This phenomenon is likely to be most significant in cases for products that are differentiated and therefore are sold on the basis of features and quality as well as price. For example, a digital camera may require that a retailer explain its unique features and quality in order to realize its maximum sales against competing digital cameras with their own unique features, or against film cameras. Or, a fashion item such as the women's accessories at issue in this case may benefit from longer store hours, more convenient or prestigious store locations, better-trained and more enthusiastic employees, or favoritism in shelf placement. From an economics perspective, all of these services can enhance the quality (real or perceived) of the product because they demonstrably have value to consumers. In such cases, investment in retail services can make consumers, as well as manufacturers and retailers, better off.

Market imperfections, however, may lead retailers to offer less than the amount of support that would be best for manufacturers and consumers. The imperfection most

commonly discussed in the economic literature is the so-called "free-rider" problem. Free riders, in this context, are competing retailers that take advantage of the fact that a prospective customer is under no obligation to purchase the product from the retailer that invests in retail-level services. A customer may take advantage of one retailer's informed sales staff, hands-on demonstrations, and convenient shopping locations and hours. Having received the value of those services, the customer may then purchase the product from another retailer that does not provide the same level of service and, therefore, can afford to sell the product for less. *See* Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & Econ. 86 (1960); G. Franklin Mathewson & Ralph A. Winter, *The Incentives for Resale Price Maintenance Under Imperfect Competition*, 21 Econ. Inquiry 337 (1983). For example, a customer may inspect, try out, and learn about a particular type of digital camera at a high-end retailer but then purchase the product from a discount retailer, through mail order, or over the internet.

Free riding creates externalities that lead each retailer—and thus retailers collectively—to spend less on service than is optimal. Each retailer's incentive is to invest in service only to the extent that the additional service costs are recouped through *its* increased sales. Some of the increased sales go to the free-riding retailers, and the full-service retailer properly ignores them when computing its gain from spending more on service. It thus spends less on service than would maximize total sales of the manufacturer's product.

Free riding can also take place where the thing of value provided by the higher-priced retailer is not services, but quality "signaling." *See* Overstreet, *supra*, at 56. Some retailers build a reputation for carrying high-quality or cutting-edge merchandise. Building such a reputation requires an investment, not only in product lines, but in the store's reputation through advertising, location, and other

expenditures. *See* Phillip Nelson, *Advertising as Information*, 82 J. Pol. Econ. 729 (1974). These investments in quality signaling also have the potential to be free-ridden upon: consumers can observe that a brand is sold in a store that they believe would sell only high-quality merchandise and, having concluded that the product is therefore of high quality, purchase it at a discount retailer that also carries it. Minimum RPM in this situation, just as in the services context, can protect the investment of the quality-signaling retailer and help ensure that this retailer can continue to fulfill this function, which for some products is of value both to consumers and to manufacturers and enhances interbrand competition. *See* Overstreet, *supra*, at 56-62.

Minimum RPM agreements can ameliorate the free-rider problem by helping ensure that retailers that do not provide service cannot underprice the retailers that do. By mandating a minimum resale price, the manufacturer can calibrate the level of services offered by retailers to the level at which the manufacturer's profits are maximized (which, once the manufacturer has set its price, is when the greatest amount of output is sold). In some instances, full-service retailers may actually charge less under minimum RPM, because they will be assured of more volume that otherwise would have gone to free-riding discounters. In the long run, minimum RPM thus may "reduce the maximum, and possibly the average, price charged" for the product. Mathewson & Winter, *supra*, 21 Econ. Inquiry at 347. Where free riding exists, minimum RPM arrangements generally increase overall consumer welfare. *See id.*; *see also* Elzinga & Mills, *supra*, manuscript at 7-9 (discussing the conditions under which minimum RPM may increase or decrease total welfare). One reason for the likely net procompetitive effect is that, as explained below, manufacturers have strong incentives to avoid prescribing resale prices that increase retailer margins without inducing them to provide desired retail services.

Minimum RPM is not the only method by which manufacturers can address free-riding concerns, but under some circumstances it may be the only practical one or the most competitive one. There are three principal ways other than RPM to address free riding. First, manufacturers can contract with retailers for specific services. However, the nature of marketing and selling is such that it may be difficult to specify completely all of the services that the retailer must perform and the level at which it must perform them. It is also possible that the retailer, rather than the manufacturer, knows which retail-level services will be most effective in maximizing the competitiveness of the product, or that the most effective services will be discovered only through experience with the market and will be more apparent to the retailer than to the manufacturer. Alternatively, manufacturers could charge consumers directly for point-of-sale services. However, that normally is not practical because the services provided by retailers frequently are informational or because there are economies of scale or scope that retailers which sell a range of products can take advantage of, thereby reducing their cost of providing such services. Finally, a manufacturer might use non-price vertical restraints (such as exclusive territories) to preclude *all* competition from free riders. As discussed below, this alternative is more restrictive of competition and perhaps less efficient than minimum RPM.

The potential for RPM to ameliorate a free riding problem and thereby enhance interbrand competition does not mean that it is procompetitive in every case. While alternative methods of curtailing free riding might not, as explained above, always be available or most efficient, where they are RPM may not offer an incremental benefit to interbrand competition that would offset the diminution of intrabrand competition. Moreover, the benefits of RPM may be meager in highly concentrated markets where there is not much interbrand competition to be enhanced. *See* F.M.

Scherer, *Industrial Market Structure and Economic Performance* 542-49 (3d ed. 1990) (showing that RPM may reduce both consumer and social welfare under a plausible hypothesis regarding its impact on demand for the product); Robert L. Steiner, *The Nature of Vertical Restraints*, 30 Antitrust Bull. 143 (1985) (arguing that certain types of vertical restraints, including exclusive dealing coupled with RPM, are especially detrimental to intrabrand competition).

2. Ensuring Dealer Contribution to Product Quality

Even absent free riding, retailers may not be inclined to make the level of investments in service that would maximize the overall competitiveness of a manufacturer's products. According to Klein and Murphy, minimum RPM can help ensure a desired level of investment in retail services. A manufacturer can threaten to terminate a dealer that provides inadequate service, but given the difficulties of monitoring service levels a retailer may be willing to bear the risk of termination rather than incur the cost of providing additional services. It may be less inclined to do so where the risk it faces is losing an RPM-enhanced margin. *See* Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & Econ. 265, 265-70 (1988); *see also* Andrew N. Kleit, *Efficiencies Without Economists: The Early Years of Resale Price Maintenance*, 59 S. Econ. J. 597 (1993) (applying the Klein-Murphy theory to RPM cases litigated before the advent of modern economic thought about vertical restraints).

With minimum RPM, retailers' choice of value-added services are determined and disciplined by market competition with other retailers. By eliminating intrabrand price competition among dealers, minimum RPM effectively shifts intrabrand competition to the non-price arena—that is, retailers compete to find the service package that best drives sales of the product. Elzinga & Mills, *supra*, manuscript at

4. This competition benefits consumers, who receive the package of retail-level services most useful to them; benefits retailers that develop the package, and thereby compete successfully against other retailers selling either the same or different products; and benefits the manufacturer, whose sales thereby increase.

3. Managing Demand Uncertainty

There is also support for the proposition that RPM can help to stabilize demand for a product where retailers must order their inventories of the product before demand for it is known. *See* Raymond Deneckere et al., *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 Am. Econ. Rev. 619 (1997). If demand proves unexpectedly low after retailers have acquired a substantial inventory, prices can plummet as retailers liquidate their holdings. By preventing this precipitous decline, minimum RPM can benefit consumers by encouraging retailers to maintain appropriate inventory levels. Knowing that RPM provides them with some protection in case demand is low, dealers may be willing to place larger orders in advance of knowing the demand, thereby ensuring adequate stocks if demand turns out to be high. Similarly, dealers may be more willing to invest in inventory in more innovative and risky products or styles, which can enhance product variety and benefit competition and consumers.

C. The Economics Literature Does Not Support the Conclusion that Minimum RPM Often, Much Less Invariably, Has an Anticompetitive Effect

1. Minimum RPM's Enhancement of Interbrand Competition Offsets Its Effect on Intrabrand Competition

Minimum RPM inherently restrains intrabrand price competition (competition among resellers of the brand that is

the subject of the agreement). As this Court has recognized, however, the principal form of competition that the antitrust laws encourage is interbrand competition (competition among the products of different manufacturers). *See, e.g.*, *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 724-26 (1988); *GTE Sylvania*, 433 U.S. at 54-55. As noted above, the manufacturer that uses minimum RPM can enhance interbrand competition by causing resellers to provide additional services that will increase the product's competitiveness against other products and increase sales of the product. Thus, even where minimum RPM raises the price charged by a given retailer, that does not mean that there is necessarily an anticompetitive effect. *See Sharp*, 485 U.S. at 728.

In a world of imperfect information, it is, of course, possible that a manufacturer will erroneously prescribe minimum resale prices that are higher than optimal and that will lead to lower, not higher, sales. But the manufacturer has incentives to avoid doing so. It gains no profits from having its dealers charge excessive prices or furnish unwanted service. To the contrary, where the prescribed resale price exceeds the level that optimizes the sales of the brand, the manufacturer is the loser, just as it is where the price is below the optimal level. In the ordinary case, therefore, manufacturers will strive to avoid setting resale prices above what the market calls for. In all events, it is not the function—or capacity—of antitrust law to prevent such errors. That is what markets are for. *See* Elzinga & Mills, *supra*, manuscript at 9 (citing Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 6, 21 (1981)); *see also* Frank H. Easterbrook, *Contract and Copyright*, 42 Hous. L. Rev. 953, 957 (2005) ("Markets are *much* better than judges at sifting efficient from anticompetitive practices." (emphasis in original)).

2. *The Economics Literature Does Not Support the Conclusion that Minimum RPM Is Often Used to Facilitate Manufacturer Cartels*

One objection to minimum RPM that had some traction historically is that it might be used to facilitate a cartel at the manufacturer level. There is no reason to believe, however, that this occurs frequently, or that a *per se* rule is needed to address any cases in which it does occur.

Most cartels do not involve manipulation or control of downstream resale prices, but minimum RPM has been proposed as one means by which a cartel can dissuade cheating by its members, which have incentives to reduce prices slightly and thereby gain market share. Cartel members seeking to prevent "cheating" on their agreement ideally would observe each other's prices directly. Market circumstances or prudence, however, may preclude that from happening. As an alternative, manufacturers might agree to impose RPM agreements on their dealers, so that any reduction in price by a manufacturer could not be passed on to the consumer by the retailer, but would enrich only the retailer. With no benefit to consumers, demand for the product would not increase, and the would-be "cheat" would not benefit from its reduced prices.

There are reasons to believe that this type of use of minimum RPM would not be very common.

First, this situation could arise only where manufacturers had agreed to a criminal cartel and where market conditions made such a cartel practical. Thus, it would not apply where a manufacturer is law-abiding or where the number of competing manufacturers, the ease of entry, or other market circumstances rendered a successful cartel implausible. *See* Overstreet, *supra*, at 19-23. *See generally* George Stigler, *A Theory of Oligopoly*, 72 J. Pol. Econ. 44 (1964) (discussing prerequisites for effective horizontal coordination); U.S.

Dep't of Justice & Fed. Trade Comm'n, *Horizontal Merger Guidelines* §§ 2.11, 2.12 (1992), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104 (Apr. 2, 1992) (same).

Second, it would not apply where compliance with a conspiracy can be monitored without RPM. It is noteworthy that minimum RPM has not been generally reported as an enforcement mechanism in the major price-fixing cartels that the Department of Justice has prosecuted in the past decade.

Third, there is no empirical evidence that minimum RPM is used with any frequency in this manner. To the contrary, the empirical evidence that does exist suggests that such use of minimum RPM is not common. In 1991, Pauline Ippolito of the Federal Trade Commission reported a study of the frequency with which both manufacturer cartels and retailer cartels (discussed below) were alleged in the 153 reported minimum RPM cases from 1976 to 1982. *See* Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & Econ. 263 (1991). Ippolito found that only 5.9 percent of the cases involved allegations of horizontal manufacturer price fixing in addition to RPM. She concluded, "[o]n this basis, there is little evidence . . . to support the hypothesis that the RPM law primarily deters collusion or that collusion is the primary reason for the use of RPM." *Id.* at 281.

3. The Economics Literature Does Not Support the Conclusion that Minimum RPM Is Often Used to Facilitate Reseller Cartels

It also has been suggested that minimum RPM could be used to facilitate reseller cartels. *See* Basil S. Yamey, *Origins of Resale Price Maintenance: A Study of Three Branches of Retail Trade*, 62 Econ. J. 522 (1952). Retailers that sought to form a cartel could induce manufacturers to implement minimum RPM agreements and thereby become the cartel's enforcement mechanism.

For many of the reasons mentioned above with respect to manufacturer conspiracies, the use of minimum RPM to enforce dealer cartels is not likely to be very common. Such a situation would require a retail market with high barriers to entry, because manufacturers would otherwise sell through non-colluding, lower-margin dealers. Cartelization is also an unlikely motive in markets where only one or few competitors implement RPM programs because otherwise consumers could switch to brands not encumbered by collusive retail margins. Moreover, because dealers often can observe each other's prices directly, participation by suppliers in such a cartel through minimum RPM agreements is unlikely to be necessary.

In addition, the manufacturer—a key element in these agreements—receives no benefit from a dealer cartel, but on the contrary, suffers diminished sales. Therefore, manufacturers generally lack incentives to cooperate in furthering a dealer cartel.

As with manufacturer cartels, the empirical evidence lends no support to the suggestion that minimum RPM often facilitates retailer cartels. In Ippolito's 1991 study, only 7.2 percent of the 153 minimum RPM cases reported between 1976 and 1982 contained allegations of collusion among dealers. This contributed to Ippolito's conclusion that "this evidence suggests that, on the margin, a relaxation of the *per se* rule against RPM would primarily affect noncollusive uses of RPM." Ippolito, *supra*, 34 J.L. & Econ. at 282. Overstreet, in a 1983 survey of litigated FTC minimum RPM cases, found that of the 47 cases between 1965 and 1982 for which information was available on retail market structure, 43 involved at least 100 competing retailers, a situation in which "[w]idespread dealer collusion . . . seems unlikely to be effective or persistent" absent certain market conditions. Overstreet, *supra*, at 80. He observed that "[i]t seems reasonable to conclude that for the majority of these (47)

cases the use of RPM was not likely motivated by collusive dealers who had successfully coerced their suppliers into using RPM to facilitate a widespread dealers' cartel." *Id.*

4. The Disagreements in the Economics Literature Provide No Basis for a Per Se *Rule*

There is some disagreement within the economics literature, and among *amici*, regarding the frequency with which minimum RPM has procompetitive or anticompetitive effects. Upon careful scrutiny, however, it is apparent that the range of the disagreements underscores that a rule of *per se* illegality should not be applied to minimum RPM.

In the theoretical literature, it is essentially undisputed that minimum RPM can have procompetitive effects and that under a variety of market conditions it is unlikely to have anticompetitive effects. The disagreement in the literature relates principally to the relative frequency with which procompetitive and anticompetitive effects are likely to ensue. The critical issue is the boundaries of that dispute. Some believe that minimum RPM is almost always benign and thus should basically be ignored by antitrust law except when it is part of a cartel case. *See, e.g.*, Elzinga & Mills, *supra*, manuscript at 14-15. Others believe that RPM has been demonstrated to be anticompetitive in some cases and thus merits serious antitrust consideration. *See, e.g.*, F.M. Scherer, *Comment on Cooper et al.'s "Vertical Restrictions and Antitrust Policy,"* 1 Competition Pol'y Int'l 65 (2005); William S. Comanor et al., *Vertical Antitrust Policy as a Problem of Inference: The Response of the American Antitrust Institute* (Am. Antitrust Inst. Working Paper No. 05-04, Apr. 18, 2005), *available at* http://www.antitrustinstitute.org/recent2/408.pdf. The position absent from the literature is that minimum RPM is most often, much less almost invariably, anticompetitive. Thus, the economics literature provides no support for the application of a *per se* rule.

II. RULE OF REASON TREATMENT OF MINIMUM RPM IS NEEDED TO MAINTAIN DESIRABLE CONSISTENCY BETWEEN PRICE AND NON-PRICE RESTRAINTS

Antitrust law has moved steadily in the direction of evaluating vertical restraints under the rule of reason, and appropriately so. Maximum RPM and all forms of vertical non-price restraints (except, nominally, some tying arrangements) are now subject to assessment under the rule of reason.

Applying the rule of reason to minimum RPM, like almost all other vertical restraints, is appropriate because there is little difference in economic substance between price and non-price restraints. Compare minimum RPM, for example, to territorial exclusivity. Like minimum RPM, exclusive territories relieve dealers of being in price competition with each other as to the same brand of product. Yet, under the present state of the law the former is *per se* illegal whereas the latter is judged under the rule of reason.

This divergent treatment is particularly ironic because to the extent that there is a difference in economic effect between the practices it is that minimum RPM permits *more* competition. As noted, both practices eliminate intrabrand price competition. Minimum RPM, however, unlike exclusive territories, permits intrabrand non-price competition. Moreover, it leaves multiple sellers of the brand in the same geographic market to engage in interbrand competition.

Minimum RPM also may be the more efficient means of solving the free-rider problem. For example, a manufacturer may find it most efficient to have one dealer on each side of a city, because some (but not all) customers shop only on their side of a city. The free-rider problem created by those customers who would travel to the other side for a lower

price could be solved by giving one dealer an exclusive territory covering the entire city, but that solution would be inefficient in that it would forsake those consumers who would not travel across town to the remaining dealer. As compared to the use of minimum RPM to solve the free-rider problem, both the manufacturer and consumers would be worse off.

Amici submit that the Court, therefore, ought to reverse the Fifth Circuit's decision in order to reconcile the standards applicable to price and non-price restraints. There is, to be sure, economic value in precedent. By its nature, however, antitrust is intended to evolve along with economics learning and, as *GTE Sylvania* and *Khan* demonstrate, the Court has not hesitated to abandon decisions whose economic underpinning has been eroded and whose continued existence impedes, as opposed to advances, economic efficiency and consumer welfare. *Amici* respectfully submit that the rule in *Dr. Miles* cannot be reconciled with this Court's analysis in *GTE Sylvania*. By far, a more appropriate rule is to evaluate vertical minimum resale price agreements under the traditional rule of reason standard.

CONCLUSION

For the foregoing reasons, the Court should reverse the decision of the United States Court of Appeals for the Fifth Circuit and overrule the *per se* rule against minimum RPM.

Respectfully submitted,

Joseph Angland
Counsel of Record
Stephen V. Bomse
August T. Horvath
HELLER EHRMAN LLP
Times Square Tower
Seven Times Square
New York, NY 10036
(212) 832-8300

Counsel for Amici Curiae

January 22, 2007

APPENDIX:
LIST OF *AMICI CURIAE*

William J. Baumol
Harold Price Professor of Entrepreneurship and Academic Director of the Berkeley Center for Entrepreneurial Studies
Stern School of Business, New York University

Timothy F. Bresnahan
Landau Professor in Technology and the Economy and Chair
Department of Economics, Stanford University
Former Deputy Assistant Attorney General for Economic Analysis, U.S. Department of Justice, Antitrust Division (1999-2000)

Robert W. Crandall
Senior Fellow, Economic Studies
Brookings Institution

David S. Evans
Lecturer, University of Chicago Law School
Executive Director, Jevons Institute for Competition Law and Economics and Visiting Professor, University College London

Franklin M. Fisher
Jane Berkowitz Carlton and Dennis William Carlton Professor of Economics, Emeritus
Massachusetts Institute of Technology

Luke M. Froeb
William Oehmig Associate Professor of Management
Vanderbilt University
Former Director, Bureau of Economics, Federal Trade Commission (2003-05)

Richard J. Gilbert
Professor of Economics
University of California, Berkeley
Former Deputy Assistant Attorney General for Economic Analysis, U.S. Department of Justice, Antitrust Division (1993-95)

Jerry Hausman
John and Jennie S. MacDonald Professor of Economics
Massachusetts Institute of Technology

Andrew Joskow
Senior Vice President
NERA Economic Consulting
Former Deputy Assistant Attorney General for Economic Analysis, U.S. Department of Justice, Antitrust Division (1996-97)

Benjamin Klein
Professor Emeritus, Economics
University of California, Los Angeles

G. Franklin Mathewson
Professor of Economics and Director of the Institute for Policy Analysis
University of Toronto

Paul Milgrom
Leonard and Shirley Ely Jr. Professor of Economics
Stanford University

Kevin M. Murphy
George J. Stigler Distinguished Service Professor of Economics
Graduate School of Business, University of Chicago

Philip B. Nelson
Principal
Economists Incorporated

Janusz A. Ordover
Professor of Economics
New York University
Former Deputy Assistant Attorney General for Economic Analysis, U.S. Department of Justice, Antitrust Division (1991-92)

Thomas B. Overstreet
Vice President
CRA International

Robert S. Pindyck
Bank of Tokyo-Mitsubishi Professor of Economics and Finance
Sloan School of Management
Massachusetts Institute of Technology

David Scheffman
Adjunct Professor of Business Strategy and Marketing
Owen Graduate School of Management, Vanderbilt University
Former Director, Bureau of Economics, Federal Trade Commission (2001-03)

Richard L. Schmalensee
John C Head III Dean
Sloan School of Management
Massachusetts Institute of Technology

Carl Shapiro
Transamerica Professor of Business Strategy
Walter A. Haas School of Business, University of California, Berkeley
Former Deputy Assistant Attorney General for Economic Analysis, U.S. Department of Justice, Antitrust Division (1995-96)

Bruce R. Snapp
Principal
Microeconomic Consulting and Research Associates, Inc.

Pablo Spiller
Jeffrey A. Jacobs Distinguished Professorship in Business and Technology
Chair, Haas Business and Public Policy Group
Haas School of Business
University of California, Berkeley

Frederick R. Warren-Boulton
Principal
Microeconomic Consulting and Research Associates, Inc.
Former Deputy Assistant Attorney General for Economic Analysis, U.S. Department of Justice, Antitrust Division (1985-89)